Assembly Banking & Finance Committee &

Assembly Public Employees, Retirement & Social Security Committee

Joint Informational Hearing

"Insight into the Financial Market Bailout: Present and Future Actions"

Beginning last year the Assembly Banking & Finance Committee convened its first hearing to examine the impact of the mortgage crisis on California and the devastating impact on communities and homeowners. As noted then, the subprime crisis that was impacting homeowners was only the tip of the spear as the breadth of the true crisis and its impacts were yet unknown. Subsequently, the committee conducted several other hearings regarding the direct impacts of the foreclosure and subprime crisis.

The last few weeks and months have revealed the true nature of this crisis as major financial institutions have failed, markets have plummeted and as University of Chicago economists Douglas Diamond and Anil Kashyap have pointed out "the most remarkable period of government intervention into the financial system since the Great Depression." First we witnessed the U.S. Treasury takeover of Fannie Mae and Freddie Mac with combined assets and guarantees of over $5 trillion. Not long after, Lehmon brothers became the largest bankruptcy in American history, while a few days later the federal government bailed out American International Group (AIG) with $85 billion dollars.

In the week right after the passage of HR 1424 the Emergency Economic Stabilization Act of 2008, the bill which was intended to provide confidence in the markets, the DOW lost 20% of its value. This current liquidity crisis, a direct result of inadequate risk management on the part of financial institutions has now rebounded to an irrational fear of lending money, even in the best of circumstances. The London Interbank Offer Rate (LIBOR), the calculation used by banks to determine the rate at which they will lend to each other has been hovering around 4.75% a full 3% ahead of where it was prior to 2007. This is indicative of the lack of lending among banks and eventually to consumers and businesses.

On October 14, 2008 U.S. officials announced a plan to take stakes in the nine largest financial institutions as the beginning of a program to funnel $250 billion directly into banks to free up liquidity and credit. This first round of this plan will involve Treasury purchasing $25 billion in preferred stock of Bank of America, J.P. Morgan and Citigroup, between $20 billion and $25 billion in Wells Fargo; $10 billion in Goldman and Morgan Stanley; $3 billion in Bank of New York Mellon; and about $2 billion in State Street.

Institutions that participate in this direct injection would have to comply with the executive compensation restrictions put in place under HR 1424 that do the following:

- Ensure that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution;

- Require clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate;

- Prohibit a financial institution from making any golden parachute payment to a senior executive; and

- An agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. Treasury is issuing interim final rules for these executive compensation standards.

Additionally, and in order to free up day-to-day lending among banks, the FDIC will temporarily guarantee for certain types of new debt called senior unsecured debt issued by banks and thrifts.

Executive Compensation

Prior to the financial market meltdown, a number of CEO's were living the high life with bonuses, exuberant salaries and exceptional stock options. Oddly enough, the latest occurrences in the financial arena show that although these companies failed, those still coming off on top are the CEO's. CEO's continue to collect bonuses although the nation is in financial turmoil. The amount of money paid out in bonuses and golden parachutes is more money than one person sees in a lifetime. Should someone lose their job or close a business, there is no golden parachute to lean on to save the day. With such perverse incentives there is little to prevent inordinate risk taking or failed management strategies.

According to the Department of Labor in 2007, the average annual salary in the United States was $40,690. The top CEO's of many of the failed financial institutions make more than 100 times that. The latest market shocks pose the question of, if the business fails should these CEO's still receive a well above average compensation? The first of many CEO's to receive a golden parachute was Angelo Mozilo of the California based company, Countrywide Financial. Although this previous mortgage giant, now owned by Bank of America, was under scrutiny and facing criticism for questionable lending practices, Mr. Mozilo still made out with $361.7 million for the 2005-2007 year, most of it from gains on options. At this point, as the following data shows, a number of CEO's began planning ahead by rewarding themselves and employees colossal bonuses, increasing salaries and selling stock options.

The next big blow came with Fannie Mae, a company once thriving on the fact that it was separated from direct government control. The federal government had no choice but to step in and take it over. In the end, Fannie Mae became over-extending with too much subprime debt that ultimately wiped out the shareholders. This is a case where CEO Daniel Mudd was denied a golden parachute worth $9.8 million, by one estimate, though this was only made possible due to direct government action. But he still took home $11.6 million during the boom years of 2005-07, according to Equilar, an executive compensation analysis company, including $8.3 million in bonus pay.

Similar to Fannie Mae, Freddie Mac also suffered from inadequate risk management with a portfolio burdened by subprime exposure. Freddie was also taken over by the government after conditions worsened. Freddie Mac shareholders got wiped out, and the fiasco contributed to fears that bad mortgage debt would take down the economy. Additionally, small community banks that did not really participate in the subprime boom were punished due to investments in preferred stock of both Fannie and Freddie. The former Freddie Mac CEO Richard Syron walked away with $12.9 million from 2005-07, including $8 million in bonuses. But regulators did snag his golden parachute, worth an estimated $9.8 million.

Following Freddie Mac and Fannie Mae the public had to endure watching Bear Stearns hitting the bottom. Bear Stearns was the first Wall Street giant to show out of proportion weaknesses. The federal government had to guarantee up to $29 billion in bad mortgage-related assets and from there JPMorgan Chase took them over. CEO James Cayne, who left in January, lost millions on Bear stock during the plunge but he had also cashed out millions in stock before the fall. He took home $42.3 million in his final three years on the job, 2005-07, Equilar says, including $29.8 million in bonus pay for accomplishments that included leading Bear Stearns into the arena of mortgage-backed securities.

Unlike Bear Stearns, Lehman Bros. was not able to secure government backing therefore they had no other choice but to file for bankruptcy protection. The chief obstacle was concern about a $30 billion portfolio of shaky commercial-real-estate assets compiled under the watch of CEO Richard Fuld. When Lehman filed for bankruptcy, investors were wiped out, and employees lost their jobs. Despite the consequences of filing for bankruptcy felt by almost everyone at Lehman Bros. Fuld walked away with $186.5 million in earnings from the prior three years, Equilar says. Fuld, who seemed to defend his compensation while testifying before a congressional panel on Oct. 6, 2008 got most of that by cashing out options but he also took home $36.8 million in bonus and incentive pay.

The big insurance giant, American International Group (AIG), under the leadership of CEO Martin Sullivan, got itself in deep trouble through the use of exotic financial products known as credit default swaps. In September, the insurer needed an $85 billion bailout from the Federal Reserve to avoid bankruptcy. AIG shareholders were virtually wiped out in the deal but Sullivan, who left the company in June, came out of it

a multimillionaire. He raked in $25.4 million in take-home pay over three years, according to Equilar. Furthermore, recent revelations have shown that AIG spent $440,000 on a spa get-away junket not long after accepting the federal bailout.

Next came, Merrill Lynch under the leadership of Stan O'Neal. Merrill Lynch took more than $10 billion in write-downs on bad debt in the second quarter. Fears about what was yet to come forced Merrill to accept a buyout from Bank of America to avoid disaster. O'Neal left Merrill a year ago with $66 million in earnings under his belt for 2005-07. That included $32.6 million in bonuses.

Kerry Killinger, CEO of Washington Mutual plunged headfirst into the kinds of adjustable-rate mortgages and home-equity loans that were destined to go bad when homeowners could not refinance and loan modification were not happening fast enough. The largest U.S. savings and loan faced losses from residential mortgages of as much as $19 billion when it was seized by the FDIC and then sold to JPMorgan Chase but Killinger took home $36 million in 2005-07. That included $11 million in bonus pay for his performance.

Like Washington Mutual, bad loans piled up too high at Wachovia; in the second quarter of 2008 alone, the bank reported an $8.9 billion loss. The chief culprit: "pick-a-pay" loans that came in the door when Wachovia bought California thrift Golden West Financial in 2006. Golden West specialized in those risky mortgages. Wachovia seems to have become an inquisition of Wells Fargo. CEO G. Kennedy Thompson, who left in June, did well during his tenure. He took home $16 million during 2005-07, including $10 million in bonus pay, Equilar says.

Last but not least, Citigroup was another of the toxic-debt machines during the housing boom. Now its shareholders are paying the price. Citigroup has taken more than $57 billion in write-downs and losses since the crunch hit, and analysts expect much more. Citigroup has been forced to cut its dividend and raise more than $30 billion. The man at the helm while the mess developed was CEO Charles Prince, who has since left the company. He earned $35.6 million in bonus pay during the boom years of 2005-07 and took home a total of $41.5 million.

As the failures show, CEO's are walking away with a lot of cash in their pockets while taxpayers are ask to pay the bill to prop up failed enterprises.

Corporate Governance:

How has corporate governance impacted the credit crisis? It is too early to make any conclusions about the management of certain banks over others. However, the lack of transparency regarding certain exotic financial instruments has been a major criticism of the corporate structure of the financial industry. Innovation and risk taking has been rewarded in contrast with transparency and conservative growth.

The Association of Chartered Certified Accountants (ACCA) a global body for professional accountants has singled out poor corporate governance at banks as a principal cause of the global credit crunch. In a recently released policy paper, ACCA said unacceptable practices had encouraged short-term thinking and poor risk assessment fuelling the ongoing financial crisis.

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization.

Of importance is how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. In particular, senior executives should conduct themselves honestly and ethically, especially concerning actual or apparent conflicts of interest, and disclosure in financial reports.

Commonly accepted principles of corporate governance include:

- Rights and equitable treatment of shareholders: Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.

- Interests of other stakeholders: Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.

- Role and responsibilities of the board: The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors. The key roles of chairperson and CEO should not be held by the same person.

- Integrity and ethical behavior: Ethical and responsible decision making is not only important for public relations, but it is also a necessary element in risk management and avoiding lawsuits.

- Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand, though, that reliance by a company on the integrity and ethics of

individuals is bound to eventual failure. Because of this, many organizations establish compliance and ethics programs to minimize the risk that the firm steps outside of ethical and legal boundaries.

- Disclosure and transparency: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

HR 1424

Emergency Economic Stabilization Act of 2008

Faced with an ongoing economic crisis that has not improved despite several instances of direct government intervention, Congress passed HR 1424, what has commonly been referred to as the $700 billion bailout package. The core of the proposal will provide access to the Treasury Secretary of up to the $700 billion over stages with $250 billion being made available immediately. They key driver of the bailout package is the ability of the government to purchase troubled assets, namely mortgage back securities and other financial instruments tied to mortgages.

Since the passage of HR 1424, Wall Street has continued to see record losses. Some indications have emerged at the time of writing this review that Treasury may alter the plan to allow government to buy stakes in financial institutions or provide direct injections of liquidity. This injection could amount to $200 billion, though early news is unclear as to whether this is part of, or in addition to the $700 billion previously authorized.

The following is a summary of the provisions of HR 1424. It is important to note that based on the provisions of the bill that Treasury Secretary is now the most powerful cabinet level position in the executive branch.

PURPOSE AND MISSION:

- Provide authority for the Secretary of the Treasury to take action as necessary to restore liquidity and stability to the financial system.

- Ensure that the authorities provided for in the legislation are used to:

- Protect home values, college funds, retirement accounts and life savings;
- Preserve homeownership;
- Promote jobs and economic growth;
- Maximize returns to the taxpayers; and
- Provide transparency and accountability.

TROUBLED ASSET RELIEF PROGRAM (TARP):

- Defines "troubled assets" as residential or commercial mortgages and any securities, obligations, or other instruments that based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which will promote financial market stability; and any other financial instrument in which if purchased would promote financial market stability.

- Provides authority to the Secretary to purchase and make commitments to purchase trouble assets from any financial institution on terms and conditions determined by the Secretary.

- Implements TARP under the new Office of Financial Stability headed by the Assistant Secretary of the Treasury to be appointed by the President.

- Provides the Secretary to take such actions as deemed necessary to carry out the provisions of TARP including, but not limited to:

    - Direct hiring authority;
    - Ability to enter into contracts for services;
    - Designating financial institutions as financial agents of the Federal Government.
    - Establish vehicles to purchase, hold and sell troubled assets; and
    - Issue regulations and guidance that may be necessary.

- Requires that within the first two days of the purchase of troubled assets the Secretary shall publish program guidelines and procedures.

- Requires the Secretary to take such steps as necessary to pevent unjust enrichment of financial institutions participating in TARP.

INSURANCE OF TROUBLED ASSETS:

- In addition to the power to purchase, trade and hold troubled assets, the Secretary is also authorized to set up a guarantee program for these assets.

- Establishment of a guarantee program will also require the establishment of premiums for such guarantees.

- Premiums will vary based on product risk and the Secretary shall publish the methodology for setting premiums.

- Upon request of a financial institution, the Secretary may guarantee the timely payment of principal of, and interest on, troubled assets in amounts not to exceed 100% of such payments.

- Establishes the Troubled Assets Insurance Financing Fund (TAIF) that will collect premiums to pay potential guarantee claims.

GUIDELINES AND CONSIDERATIONS:

- In exercising his authority, the Secretary shall take into consideration the following:

    - Protecting the interest of the taxpayers;
    - Providing stability and preventing disruption to financial markets;
    - Assist and help families keep their homes and stabilize communities;
    - Determining if the purchase of assets meat long term viability of TARP;
    - Ensuring that all financing institutions are eligible to participate in the program;
    - Providing financial assistance to community banks and to financial institutions that serve low and moderate income communities that have assets less than one billion dollars and that as a result of devaluation of Fannie and Freddie preferred stock will drop in capital levels;
    - The need to ensure stability for United States public instrumentalities; and
    - Protecting retirement accounts.

FINANCIAL STABILITY OVERSIGHT BOARD (FSOB):

- Creates FSOB, which shall be responsible for:

    - Reviewing the exercise of authority under TARP;
    - Making recommendations to the Secretary regarding use of authority under TARP; and
    - Reporting any suspected fraud, misrepresentation, or malfeasance to the Special Inspector General for the Troubled Assets Relief Program or the Attorney General of the United States.

- FSOB will be composed of the Chairman of the Federal Reserve, the Secretary, Director of FHA, Chairman of the SEC and the Secretary of HUD.

- Requires FSOB to report to Congress quarterly.

REPORTING REQUIREMENTS:

- Requires the Secretary to report to Congress within 60 days of the first exercise of authority granted under TARP to report every 30 days thereafter.

- Requires the reports to include the following:

    - An overview of actions taken under TARP;
    - Actual obligations and expenditures of funds provided for administrative expenses.
    - A detailed financial statement with respect to the exercise of authority including:

        - All agreements made or renewed;
        - All insurance contracts entered into;
        - All transactions occurring during the reporting period;
        - The nature of the assets purchased;
        - Projected costs and liabilities;
        - Operating expenses;
        - The Valuation or pricing method used for each transaction; and
        - A description of vehicles established to assist in the exercise of the authority granted under TARP.

- Requires specified Tranche Reports to Congress that include:

    - A description of all the transactions made during the reporting period;
    - Justification for the price paid for and other financial terms associated with transactions;
    - A description of the impact of TARP on the financial system;
    - A description of challenges that remain in the financial system; and
    - An estimate of additional actions under the authority provided that be necessary to meet new challenges.

- Requires the Secretary to review the current state of the financial markets and regulatory system and submit a report to Congress analyzing financial markets and providing recommendations regarding potential new regulatory action.

FORECLOSURE MITIGATION EFFORTS:

Like most provisions of the bailout bill, this section is very broad yet unspecific regarding the actions that the Treasury Secretary may take to encourage loan modifications. In granting authority to the Treasury Secretary is uses terms such as the Secretary may "encourage" modification efforts, instead of a clear grant of power to enforce such modifications. However, with $700 billion at his disposal, the Treasury Secretary encouragement may have the same effect as a mandate. It is too early to tell the full effects of this package.

Specifically, section 109 does the following:

- Requires the Secretary to implement a plan to maximize assistance to homeowners and use the authority provided to "*encourage*" loan servicers to take advantage of the HOPE for Homeowner's Program *or other* available programs to minimize foreclosures. The guidelines for the HOPE program, as passed in HR 3221 (Housing & Economic Recovery Act of 2008) are as follows:

    - The borrowers mortgage must have originated on or before January 1, 2008;

    - The mortgage debt-to-income must be at least 31 percent;

    - The borrower does not own second homes.

- Maximum 90 percent loan-to-value ratio (This requires a write down of principle to 90% of the current value as appraised by FHA);

- $550,440 maximum mortgage amount;

Considering the stringent debt-to-income ratio requirements and the requirement that lenders must write down the principle of the mortgage this program will probably suffer from little to no utilization. Also, FHA estimates that this program will only assist 400,000 borrowers.

- Provides that the Secretary may use guarantees and credit enhancements to facilitate loan modifications.

- Requires the Secretary to coordinate with other federal agencies and entities that hold troubled assets to identify opportunities for the acquisition of troubled assets that would improve the loan modification and restructuring process and to permit tenants to remain in their homes under the terms of the lease.

- In cases where the Treasury owns all or part of the assets of a mortgage pool the Secretary shall consent to "*reasonable*" requests for loss mitigation measures, including term extensions, rate reductions, principle write downs, or other means to remove limitations on modifications.

- Requires the Federal Property Manager (FPM) to implement loan modification and assistance plans within 60 days of enactment of the bill.

- Requires the FPM a report to Congress every 30 days on the number and types of loan modifications made and the number of actual foreclosures occurring during the reporting period.

- Provides that when the FPM does not own a mortgage loan, but holds as interest in obligations or pools of obligations secured by mortgage loans the FPM shall encourage implementation of loan modifications by servicers and assist in facilitating any modifications to the extent possible.

Adam Levitin, Associate Professor of Law, at Georgetown University concludes that the buying up of mortgage backed securities by the government is not enough to give the

government the ability to unilaterally modify mortgages. Typical pooling and servicing agreements (PSAs) specify that it takes two-thirds of all the MBS holers in a pool to consent to a modification. Under this scenario, Treasury would have to buy up two-thirds of the MBS in a pool to force across the board modifications. However, even if Treasury could or was willing to purchase the necessary amount, the conversion of MBS into collateralized debt obligations further dilutes the ability to purchase the sufficient number of securities. Professor Levitin advocates the best way to engage in loan modifications is too allow judges to write down values in bankruptcy proceedings.

EXECUTIVE COMPENSATION:

As noted earlier in this background, executive compensation has become a hot button issue as Americans witness CEOs walking away with multi-million dollar paydays after the collapse of their company in what can only be described as utter failures in leadership and responsibility. These are the types of failures that would get most middle income workers, regardless of industry, fired on the spot. When the first bailout plan was floated to Congress it did not include limits on executive compensation. Subsequently, Congress and the public expressed outrage at the handover of billions of dollars of taxpayer money without any limits on CEO pay or the use golden parachutes.

HR 1424 contains the following limits on compensation:

- When the Secretary directly purchases trouble assets from institutions without a bidding process and such sale results in the government having an equity or debt position in the institution, then the institution must meet specified governance and executive compensation standards.

- These standards are:

    - Exclusion of incentives for senior executive officers of institutions to take unnecessary and excessive risks that threaten the institution during the period in which the government holds and equity position.
    - A provision for recovery of any bonuses or incentive compensation based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate.
    - A prohibition on the making of any golden parachute during the period in which the government has an equity or debt position.

- If troubled assets are purchased at auction and when the investment in a single institution is at least $300,000,000 the Secretary shall prohibit, for such financial institution any new employment contracts that provide a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency or receivership.

The provisions in this section may provide little long term comfort to those concerned with executive compensation. The limits and terms are vague and narrow. For example, assistance to an institution is not enough for the protections to kick in. It requires that the government either have an actual ownership position in the institution or an investment over $300,000,000. So the TARP plan could provide $299,000,000 in assistance to one entity but the limits on executive compensation would not apply. Furthermore, recovery of bonuses or incentives is allowed if statements of earnings, etc are proven to be inaccurate. The legislation is unclear on who would make such a finding, either a court or the Secretary? Lastly, the limits only apply for the duration that the government holds an equity position so the day after that relationship ends the institution could begin to adversely reward executives even though they only survived due to government intervention.

COORDINATION WITH FOREIGN AUTHORITIES AND CENTRAL BANKS:

- Requires the Secretary to coordinate with foreign financial authorities and central banks to work toward the establishment of similar programs by foreign authorities and central banks.

The federal government and several members of Congress have, over the last few years, expressed concerns regarding the influence and reach of sovereign wealth funds, particularly those from Arab counties such as the United Arab Emirates. Ironically, the TARP program may be the beginning of the largest sovereign wealth fund in the world.

MINIMIZATION OF LONG-TERM COSTS AND MAXIMAZATION OF BENFITS FOR TAXPAYERS:

In carrying out the TARP program the Secretary is required to develop policies that will minimizes risks to the taxpayers by taking into account direct outlays, potential long-term returns and the overall economic benefits to the program. In order to carry out this provision the Secretary shall:

- Hold assets to maturity or for resale until such time that the market is optimal for selling such assets;

- Sell such assets at a price that the Secretary determines, based on available financial analysis, will maximize return on investment for the Federal Government;

- Make purchases of assets at the lowest price; and

- Use market mechanism such as auctions and reverse auctions.

Discretion is provided to the Secretary to determine whether market mechanisms are feasible, or if direct purchase would better suit the goals of the program. This section leaves this authority to make such determines entirely to the discretion of the Secretary.

Finally, TARP provides that the Secretary may not purchase any troubled assets from a financial institution, unless the Secretary receives from a publicly traded institution a warrant giving the right to the Secretary to receive nonvoting common stock or preferred stock when deemed appropriate. If the institution is not publicly traded the Secretary shall receive a senior debt instrument.

MARKET TRANSPARENCY:

- Requires the Secretary to make available to the public a description, amounts, and pricing of assets acquired under this Act, within 2 business days of purchase, trade, or other disposition.

- Provides the Secretary to determine if public disclosure of off-balance sheet transactions, derivatives, instruments, contingent liabilities and similar sources of exposure is adequate to provide sufficient information to the public that reveals the true financial condition of the entity.

OVERSIGHT AND AUDITS:

HR 1424 establishes oversight by the Comptroller General of the United States on a continuing basis that will review and audit key provisions of the act, as well as, the performance of any agents and representatives of TARP. The subjects of Comptroller oversight include:

- The performance of TARP, particularly performance issues related to,

    - Foreclosure mitigation;
    - Cost reduction;
    - Ability and effectiveness is providing stability to the financial markets; and
    - Protection of taxpayers.

- The financial condition and internal controls of the TARP, its representatives and agents.

- Characteristics of transaction and commitments.

- Characteristics and disposition of acquired assets.

- Efficiency of the operations of the TARP in the use of appropriated funds.

- Compliance with all applicable laws and regulations.

- The efforts of the TARP to prevent, identify, and minimize conflicts of interest involving any agent or representative performing activities on behalf of or under authority of the TARP.

- The efficacy of contracting procedures.

Finally, the TARP is required to annually prepare and issue to the appropriate Congressional committees the public audited financial statements prepared in accordance with generally accepted accounting principles, and the Comptroller shall annually audit such statements.

STUDY AND REPORT ON MARGIN AUTHORITY:

Requires the Comptroller General to undertake a study to determine the extent to which leverage and sudden de-leveraging of financial institutions was a factor behind the financial crisis. This report must be submitted no later than June 1, 2009. The study shall include:

- An analysis of the roles and responsibilities of the Federal Reserve Board, SEC, the Secretary, and other Federal banking agencies with respect to monitoring leverage and acting to curtail excessive leveraging.

- An analysis of the authority of the Board to regulate leverage.

- An analysis of any usage of margin authority by the board.

- Recommendations for the Board and Congress with respect to the existing authority of the Board.

SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM

Creates a special Inspector General to review and monitor the TARP with the responsibility of auditing and investigating the purchase, management, and sale of assets by the Secretary including the collection of the following information:

- A description of the categories of troubled assets purchased or otherwise procured by the Secretary.

- A listing of the troubled assets purchased.

- An explanation of the reasons the Secretary deemed it necessary to purchase each troubled asset.

- A listing of each financial institution that such trouble assets were purchased from.

- A listing of and detailed biographical information on each person or entity hired to manage such troubled assets.

- Current estimate of the total amount of troubled assets purchased and sold and a detailed account of the profits and losses incurred from the disposition of each asset.

- A listing of insurance contracts issued.

AUTHORITY TO SUSPEND MARK-TO-MARKET ACCOUTING:

First, what is mark-to-market accounting? Also known as "fair value" accounting it requires institutions to value assets on their balance sheets based on what those assets would be valued at on the market. If the current trading value of an asset is 85 cents on the dollar then that the amount that would be claimed on the balance sheets, thus causing a write down in value of 15 cents per dollar. Mutual funds make these types of reports every day on the value of the stocks in their portfolio while investment banks like Goldman Sachs do these reports every quarter. During the subprime boom financial institutions created such exotic instruments that there was no real market to which one

could base a realistic pricing analysis. In these cases, the investment firms used complex algorithms to "guess" at what the true market value of these products might be or tied their fortunes to indices that were most likely to face volatility in such a distressed market and that's exactly what has happened. Additionally, this accounting rule as required many banks to write down holdings based on the current value of real estate that backs up mortgage securities. This had contributed to a massive write down in values. Several policy makers, investors, CEOs and others have called for suspension of the mark-to-market rule, blaming it in large part for the current financial crisis, pointing out that such exotic products as collateralized debt obligations cannot possible be priced correctly in such a panicked marketplace. However, it should be noted that no one complained about the mark-to-market rules with the market place was overly optimistic and firms were able to mark large returns on their balance sheets.

HR 1424 provides the SEC with authority to suspend by rule, regulation or order the mark- to-market rule if need for the protection of investors.

Additionally, the SEC will study the mark-to-market accounting standards with an emphasis on:

- The effects of such accounting standards on a financial institutions balance sheet.
- The impacts of such accounting on bank failures.
- The impact of such standards on the quality of financial information available to investors.
- The process used by the Financial Accounting Standards Board in developing accounting standards.
- The advisability and feasibility of modifications to such standards.
- Possible alternative accounting standards to those currently provided under mark-to-market.

TEMPORARY INCREASE IN DEPOSIT AND SHARE INSURANCE COVERAGE:

In order to instill consumer confidence in the retail banking sector, the FDIC deposit insurance limit has been raised from $100,000 to $250,000 through December 31, 2009.